

TOBACCO PRODUCTS TAX GUIDELINES AND RULES

January 1, 2006

These guidelines and rules are published by the Department of Taxation ("TAX") to provide guidance to distributors of cigars, smokeless tobacco, pipe tobacco and roll-your-own tobacco regarding recent changes to the tobacco products tax made by House Bill 1885 (Chapter 71, 2005 Regular Session) that take effect on January 1, 2006.

The most significant change made by House Bill 1885 is to impose the tobacco products tax on the actual price paid by distributors of tobacco products rather than the selling price charged by wholesalers. House Bill 1885 also requires distributors to obtain a license from TAX, pay a licensing fee and undergo a background check prior to selling tobacco products. Additionally, House Bill 1885 changes the due date of the tobacco products tax return from the tenth to the twentieth of each month, provides detailed recordkeeping and audit requirements for the tax, and authorizes TAX to seize tobacco products from persons who fail to pay the tax and destroy the products.

For taxable periods beginning on and after January 1, 2006, these guidelines and rules supersede the Tobacco Products Tax Guidelines and Rules issued by TAX on February 18, 2005. House Bill 1885 provides that the development and publication of these guidelines and rules is exempt from the provisions of the Administrative Process Act (*Va. Code* § 2.2-4000 *et seq.*). TAX has worked with affected distributors to develop these guidelines and rules. As necessary, additional guidelines and rules will be published and posted on TAX's web site, www.tax.virginia.gov.

Definitions

"Affiliate" means an individual or entity that controls, is controlled by, or is under common control with another individual or entity. An individual or entity controls an entity if the individual or entity owns, directly or indirectly, more than 10 percent of the voting securities of the entity.

"Chewing tobacco" means any leaf tobacco not intended to be smoked.

"Cigar" means any roll of tobacco wrapped in leaf tobacco or in any substance containing tobacco (other than any roll of tobacco that is a cigarette).

"Cigarette" means any roll of tobacco wrapped in paper or in any substance not containing tobacco, and any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette.

"Distributor" means 1) any person engaged in the business of selling tobacco products

Tobacco Products Tax Guidelines and Rules

in the Commonwealth who brings, or causes to be brought, into the Commonwealth from outside the Commonwealth any tobacco products for sale in the Commonwealth; 2) any person who makes, manufactures, fabricates, or stores tobacco products in the Commonwealth for sale in the Commonwealth; 3) any person engaged in the business of selling tobacco products outside the Commonwealth who ships or transports tobacco products to any person in the business of selling tobacco products in the Commonwealth; or 4) any retail dealer in possession of untaxed tobacco products in the Commonwealth.

“Manufacturer” means a person who manufactures or produces tobacco products and sells tobacco products to a distributor.

“Manufacturer's representative” means a person employed by a manufacturer to sell or distribute the manufacturer's tobacco products.

“Manufacturer's sales price” means the actual price for which a manufacturer, manufacturer's representative, or any other person sells tobacco products to an unaffiliated distributor. Manufacturer's sales price is the total amount for which tobacco products are sold, valued in money, whether paid in money or otherwise, and includes any amount for which credit is given to the purchaser by the dealer, without any deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or service costs, losses or any other expenses whatsoever. Manufacturer's sales price does not include any cash discount allowed and taken or finance charges, carrying charges, service charges or interest from credit extended on sales of tobacco products. In the event that the buyer and seller are affiliates or TAX determines that the price established by the parties is not consistent with arm's length transactions involving similar products, the manufacturer's sales price must be the greater of the sales price established by the parties or the manufacturer's list price for the tobacco products.

“Person” means any individual, corporation, partnership, limited liability company, association, company, business, trust, joint venture, or other legal entity.

“Pipe tobacco” means any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco to be smoked in a pipe.

“Retail dealer” means any person who sells or offers any tobacco products for sale to consumers.

“Roll-your-own tobacco” means any tobacco which, because of its appearance, type, packaging, or labeling, is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes for personal consumption.

“Smokeless tobacco” means snuff and chewing tobacco.

“Snuff” means any finely cut, ground, or powdered tobacco not intended to be smoked.

Tobacco Products Tax Guidelines and Rules

“Tobacco products” means cigars, smokeless tobacco, pipe tobacco or roll-your-own tobacco. Cigarettes are not tobacco products.

“Voting security” means a security that 1) confers upon the holder the right to vote for the election of members of the board of directors or similar governing body of the entity, or 2) is convertible into, or entitles the holder to receive, upon its exercise, a security that confers such a right to vote. A general partnership interest must be deemed to be a voting security.

“Wholesale dealer” means any person who sells tobacco products at wholesale to retail dealers or institutional, commercial or industrial users.

Imposition of Tax

Beginning January 1, 2006, the tobacco products tax will be imposed upon distributors of tobacco products at the rate of 10 percent of the manufacturer's sales price of the tobacco products. The tax will be imposed at the time the distributor 1) brings or causes to be brought into the Commonwealth tobacco products for sale in the Commonwealth; 2) makes, manufactures, or fabricates tobacco products in the Commonwealth for sale in the Commonwealth; or 3) ships or transports tobacco products to retailer dealers in the Commonwealth to be sold by those retail dealers in the Commonwealth. The distributor who first possesses the tobacco product subject to the tax in the Commonwealth will be the distributor liable for the tax. The tax will be imposed once, and only once, on all tobacco products for sale in the Commonwealth.

In the event that tobacco products on which the Virginia tobacco products tax has been paid are later sold outside of the Commonwealth, the distributor who paid the tobacco products tax may apply to TAX for a credit or a refund of the tax as provided in these guidelines and rules.

The tax does not apply to any transactions in interstate or foreign commerce, or to the federal government, its agencies and instrumentalities that, under provisions of the United States Constitution, Virginia is prohibited from taxing.

Distributor's License Required

No person may engage in the business of selling tobacco products as a distributor in the Commonwealth without first having received a separate license from TAX for each place of business. A person located outside the Commonwealth who ships or transports tobacco products to retailers in the Commonwealth may also apply for a license.

TAX may at any time revoke the license issued to any distributor who violates any of the provisions of the tobacco products tax law, or of these guidelines and rules. No license may be transferred to another person.

Tobacco Products Tax Guidelines and Rules

Each distributor must prominently display its license, or a copy thereof, at the licensed premises and provide a copy to each wholesale or retail dealer located in the Commonwealth to whom it sells tobacco products. In the event that its license expires or is revoked, the distributor must immediately notify each wholesale or retail dealer located in the Commonwealth to whom it sells tobacco products.

TAX will compile and maintain a current list of licensed distributors that will be updated on a monthly basis and posted on TAX 's web site. Persons who purchase tobacco products for resale should check this list frequently to ensure that they are buying from licensed distributors.

Applying for a Distributor's License

As the process of reviewing applications and conducting background investigations will take several months, TAX will notify each taxpayer currently registered for the tobacco products tax when it must apply for a license. Distributors who are currently registered with TAX for the tobacco products tax will be considered licensed distributors until notified by TAX that they need to apply for a distributor's license. In order to stagger license renewal dates, TAX will initially issue licenses that are valid for periods ranging from 2 to 4 years. Subsequently, distributor's licenses will be valid for a period of three years from the date of issue.

Every application for a license must be made on a form prescribed by TAX and the following information must be provided:

1. The name and address of the applicant. If the applicant is a corporation, it must also provide the name and address of its principal officers. If the applicant is any other type of legal entity, it must also provide the name and address of each of its members;
2. The address of the applicant's principal place of business;
3. The location where the business to be licensed is to be conducted; and
4. Such other information as TAX may require.

Application forms are available on TAX's web site, www.tax.virginia.gov.

Distributor's License Application Fee

Each application for a distributor's license must be accompanied by a fee, not to exceed \$750 for a three-year application. Initial licenses issued for periods other than three years will be prorated accordingly. In the event that the applicant has more than one place of business, TAX may waive the application fee for its other places of business. In the event that the applicant has paid an application fee to obtain a cigarette stamping permit for a location, TAX may waive the tobacco products tax license application fee

Tobacco Products Tax Guidelines and Rules

for that location.

The application fee will be applied to TAX's administrative and other costs of processing distributor's license applications, conducting background investigations and issuing distributor's licenses. Any amount collected in excess of such costs as of June 30 in even numbered years will be reported to the State Treasurer and deposited into the state treasury.

Distributor's License Background Check

TAX will conduct a background investigation of the applicant and such of its officers and employees as deemed necessary by TAX. The background investigation may include a Virginia Criminal History Records search. TAX may also conduct a National Criminal Records search and fingerprinting in the manner required by the Federal Bureau of Investigation. In addition to the background investigations required to obtain a license, TAX may conduct background investigations of officers and employees hired after the license is issued or renewed. TAX may also require distributors to notify TAX of personnel changes in positions requiring a background investigation.

TAX may refuse to issue a distributor's license or may suspend, revoke or refuse to renew a distributor's license if it determines that the applicant or any of its officers and employees have been 1) found guilty of any fraud or misrepresentation in any connection; 2) convicted of robbery, extortion, burglary, larceny, embezzlement, fraudulent conversion, gambling, perjury, bribery, treason, or racketeering; or 3) convicted of a felony. Any person who knowingly and willfully falsifies, conceals or misrepresents a material fact or knowingly and willfully makes a false, fictitious or fraudulent statement or representation in an application for a distributor's license is guilty of a Class 1 misdemeanor.

Filing of Monthly Tax Returns

Starting with the January 2006 return (due February 20, 2006), the Monthly Tobacco Products Tax Return will be due on the twentieth rather than the tenth of each month. Changes to the tobacco products tax that take effect on January 1, 2006 will also be first reflected on the return due February 20, 2006.

A return must be filed by each registered distributor each month, even if no tax is due for that month. The tax due on tobacco products subject to tax in the preceding month will be paid at the time the return is filed.

Each return must show the quantity and manufacturer's sales price of each tobacco product 1) brought, or caused to be brought, into the Commonwealth for sale in the Commonwealth, and 2) made, manufactured, or fabricated in the Commonwealth for sale in the Commonwealth, during the preceding calendar month. Every licensed distributor outside the Commonwealth must file a return showing the quantity and manufacturer's sales price of each tobacco product shipped or transported to retailers in

Tobacco Products Tax Guidelines and Rules

the Commonwealth to be sold by those retailers, during the preceding calendar month.

Distributors will be required by TAX to complete and retain detailed schedules supporting any adjustments taken on monthly returns, including but not limited to:

- Previously taxed tobacco products that have been returned to the manufacturer.
- Previously taxed tobacco products that have been exchanged for untaxed tobacco products with the manufacturer.
- Previously taxed products sold to other states.
- Exempt sales.
- Sales or purchases of previously untaxed products.

Forms and schedules are available on TAX's web site, www.tax.virginia.gov.

Distributor's Discount

For the purpose of compensating distributors for accounting for the tobacco products tax, each distributor will be allowed to deduct two percent of the tax otherwise due when filing its monthly return and paying the tax, if the amount due was not delinquent at the time of payment.

Penalties and Interest

Any distributor who fails to file a return or pay the full amount of the tax due will be subject to a penalty equal to five percent of the tax due if the failure is for not more than one month, with an additional two percent for each additional month, or fraction thereof, during which the failure continues, not to exceed 20 percent in the aggregate. In no case, however, will the penalty be less than \$10 and the minimum penalty will apply whether or not any tax is due for the period for which such return was required. TAX has, in its discretion, the authority to waive these penalties. Interest will accrue until the tax is paid.

Any distributor who files a false or fraudulent return with willful intent to defraud the Commonwealth, or willfully fails to file a return with the intent to defraud the Commonwealth, will be subject to a penalty equal to 50 percent of the tax due. It will be prima facie evidence of intent to defraud the Commonwealth when any distributor reports its tax liability at 50 percent or less of the actual amount due.

Refunds and Credits

In the event that TAX determines that the amount paid regarding any monthly return was greater than the amount of tax due the Commonwealth, the excess may be taken

Tobacco Products Tax Guidelines and Rules

as a credit by the distributor against a subsequent month's tobacco products tax liability. If, however, the distributor requests a refund, such excess will be refunded to the distributor within 45 days of the request. The refund will include interest from the due date of the return to which such excess is attributable to or the date such excess was paid to TAX, whichever is later, and end on a date determined by TAX preceding the date of the refund check by not more than seven days.

Recordkeeping

Each distributor must keep in each licensed place of business complete and accurate records for that place of business, including itemized invoices of: 1) tobacco products held, purchased, manufactured, brought in or caused to be brought in from outside the Commonwealth or shipped or transported to retailers in the Commonwealth; 2) all sales of tobacco products made; 3) all tobacco products transferred to other retail outlets owned or controlled by that licensed distributor; and 4) any other records required by TAX. All such books, records and other papers and documents must be preserved for a period of at least three years, unless TAX authorizes, in writing, their destruction or disposal at an earlier date. At any time during usual business hours, duly authorized agents or employees of TAX may enter any place of business of a distributor and inspect the premises, the books, records and other papers and documents required to be kept and the tobacco products contained therein.

Each distributor who sells tobacco products to persons other than an ultimate consumer must render with each sale itemized invoices showing the distributor's name and address, the purchaser's name and address, the date of sale, all prices, and the wording "Virginia Tobacco Products Tax Paid." In the event that items subject to the tobacco products tax are sold with items not subject to the tax, the invoice must show separate subtotals for taxable and nontaxable items or the seller must issue separate invoices for taxable and nontaxable items. The seller must preserve legible copies of invoices for three years after the date of sale.

Each distributor must procure itemized invoices of all tobacco products purchased. The invoices must show the name and address of the seller and the date of purchase. The distributor must preserve a legible copy of each invoice for three years after the date of purchase.

Persons failing to make records available for inspection by TAX during regular business hours are guilty of a Class 2 misdemeanor under *Va. Code* § 58.1-103.

Unlawful Importation, Transportation or Possession of Tobacco Products

It is unlawful for any person who is not a licensed distributor to import, transport, or possess, for resale, any tobacco products in the Commonwealth, or under circumstances and conditions that indicate that tobacco products are being imported, transported, or possessed in a manner as to knowingly and intentionally evade or attempt to evade the tobacco products tax. Such tobacco products are subject to

Tobacco Products Tax Guidelines and Rules

seizure, forfeiture and destruction by TAX or any law-enforcement officer of the Commonwealth. All fixtures, equipment, materials and personal property used in substantial connection with the sale or possession of tobacco products involved in a knowing and intentional violation of the tobacco products tax are subject to seizure and forfeiture.

Appeals

Taxpayers may appeal tobacco products tax issues to TAX using the administrative appeals process applicable to other state taxes administered by TAX set forth in Va. Code § 58.1-1820 *et seq.*

Examples

Example 1:

A wholesale dealer located in Virginia and other states sells tobacco products to retail and wholesale dealers located in Virginia and other states. The wholesale dealer is a distributor and must: 1) obtain a license from TAX; 2) provide a copy of its license to each of its customers located in Virginia; 3) file monthly returns concerning its purchases of tobacco products during the preceding month for its Virginia locations; and 4) pay the tax due regarding such purchases at the time the return is filed.

Example 2:

A chain store distribution center located in Virginia distributes tobacco products to its stores located in Virginia and other states for sale at wholesale and retail. The chain store distribution center is a distributor and must: 1) obtain a license from TAX; 2) provide a copy of its license to each of its customers that are wholesale or retail dealers located in Virginia; 3) file monthly returns concerning its purchases of tobacco products during the preceding month for its Virginia locations; and 4) pay the tax due on such purchases at the time the return is filed.

Example 3:

A retail dealer located in Virginia buys tobacco products exclusively from a licensed distributor. The retail dealer: 1) has obtained a copy of the distributor's license issued by TAX; 2) has not been notified by the distributor or TAX that the registration has been terminated; and 3) each invoice received from the wholesale dealer reflects that the tobacco products tax due regarding the products listed on the invoice will be paid by the distributor by the wording "Virginia Tobacco Products Tax Paid." Regardless of whether the distributor is located in Virginia or another state, the retail dealer is not a distributor and is not required to obtain a license with TAX, file a monthly return or to pay the tax regarding these purchases.

Tobacco Products Tax Guidelines and Rules

Example 4:

A retail dealer located in Virginia buys tobacco products exclusively from a wholesale dealer located in another state that has not obtained a tobacco products tax license from TAX. The retail dealer is a distributor and must: 1) obtain a license from TAX; 2) file monthly returns concerning its purchases of tobacco products during the preceding month; and 3) pay the tax due on such purchases at the time the return is filed. In this example, the manufacturer's sales price would be the purchase price paid by the retail dealer.

Example 5:

A retail dealer located in Virginia buys tobacco products from different wholesale dealers located in Virginia and other states. Some out-of-state wholesale dealers are licensed by TAX, some are not. The retail dealer is a distributor and must 1) obtain a license from TAX; 2) file monthly returns concerning its purchases of tobacco products during the preceding month; and 3) pay the tax due on such purchases at the time the return is filed. The monthly return must list all tobacco products purchased with the exception of purchases where: a) the retail dealer has obtained a copy of the distributor's license issued by TAX; b) has not been notified by the distributor or TAX that the license has been terminated; and c) each invoice received from the wholesale dealer reflects that the tobacco products tax due regarding the products listed on the invoice will be paid by the distributor by the wording "Virginia Tobacco Products Tax Paid."

Example 6:

A manufacturer located outside of Virginia sells 1,000 packages of tobacco products with a list price of \$1 each to a distributor for \$1,000 in March. The distributor resells the 1,000 packages to a retail dealer located in Virginia for \$1,500 in March. The distributor's return due in April will include the \$1,000 manufacturer's sales price and an associated tax liability of \$100.

Example 7:

On a two-for-one promotion, a manufacturer located outside of Virginia sells 2,000 packages of tobacco products with a list price of \$1 each to a distributor for \$1,000 in March. The distributor resells the 2,000 packages to a retail dealer located in Virginia for \$1,500 in March. The distributor's return due in April will include the \$1,000 manufacturer's sales price and an associated tax liability of \$100.

Example 8:

A licensed distributor located in Virginia purchases 10,000 packages of tobacco products on March 1 for sale to retail and wholesale dealers located in Virginia and other states. During March, the distributor sells 2,000 of these packages to dealers

Tobacco Products Tax Guidelines and Rules

located in other states. During April, the distributor sells 3,000 of these packages to dealers located in other states. The distributor's return due in April will include the 10,000 packages purchased in March, as well as a credit for the 2,000 packages sold in March to customers located in other states. The distributor's return due in May will include a credit for the 3,000 packages sold in April to dealers located in other states.

Example 9

On January 1, 2006, a wholesale dealer located in Virginia possesses 2,000 packages of untaxed tobacco products purchased prior to January 1, 2006. The dealer is liable for the tax on untaxed tobacco products purchased prior to January 1, 2006 when he ships or transports the tobacco products to retailers in the Commonwealth. The dealer sells 1,000 packages to Virginia retailers in January and 1,000 packages in February. The dealer should report the purchase price of the 1,000 packages sold in January on his return due in February and the purchase price of the 1,000 packages sold in February on his return due in March.

Additional Information

These guidelines are available on-line in the Tax Policy Library section of TAX's web site, located at www.tax.virginia.gov. For additional information, please contact the Office of Customer Services, Department of Taxation, P.O. Box 715, Richmond, Virginia 23218-0715 or call (804) 371-0730.

Approved:

Kenneth W. Thorson

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Tax Commissioner

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